Investment Review & Outlook

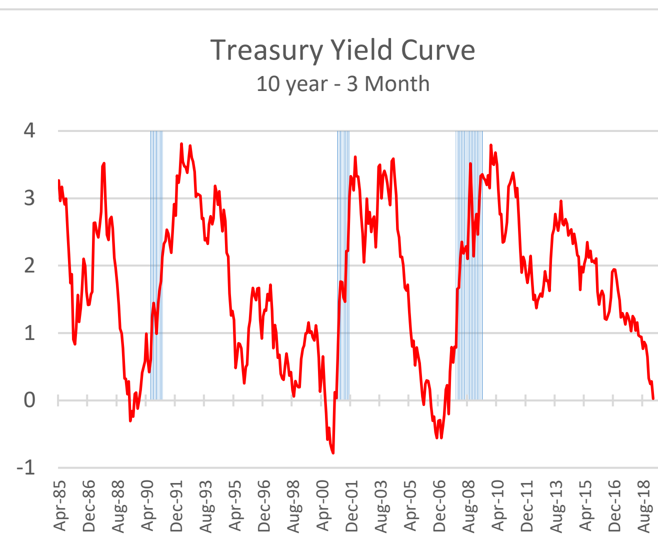
April 2019

Review

The Federal Reserve took much of the center stage during the first quarter with bit parts filled by the trade talks with China and ECB President Mario Draghi. Trade talks between the U.S. and China resumed at the close of 2018 and have continued on and off since. Progress has been slow yet consensus opinion suggests that as long as both parties remain in active talks, then the likelihood of a trade deal being signed before June remains high.

The Fed reversed course on raising short-term interest rates twice in 2019 in favor of an extended pause in their upward march. Jay Powell's European counterpart, European Central Bank President Mario Draghi, similarly gave the markets something to worry about in late December after the ECB indicated that it would halt the policy of adding liquidity to the financial system through Quantitative Easing. QE in Europe was launched in March of 2015 and has delivered few results. In late December, Mr. Draghi indicated that the ECB would soon be ending QE and may soon be raising interest rates. In the early part of March, the ECB abandoned its plans to reign in QE and instead added even more monetary support. The Chinese government, faced with slowing growth, has been adding financial and monetary stimulus as well.

The Fed' reversal led to a sharp fall in the 10-year US Treasury yield, while short-term maturities where held steady by the Fed's "pause" announcement. The result was what is called an "inverted" yield curve where 3-month Treasury Bills offer a higher yield than 10-year Treasury Notes as represented by falling below zero on the chart below.



Note: Blue columns represent recession periods.

Data sources: Standardandpoors.com, Bloomberg, MSCI.com *Continued on page 2*

Global Markets

The U.S. major stock indices recorded some of the best gains in nearly a decade as individual stocks surged off their Christmas Eve lows. For the first quarter ending March 29, the Dow Jones Industrial Average gained 11.2%, the S&P 500 gained 13.1% and the NASDAQ Composite gained 16.5%. The gains left the DJIA and S&P 500 both within less than 3.5% from their all-time highs established back in late September /early October while the tech heavy NASDAQ is about 4.5% off its all-time high set on August 31. Technology and Industrials led the S&P 500 higher, while Health Care and Financials lagged.

The Bloomberg Barclays 3-5 year US Treasury Index moved higher throughout the first quarter, generating a total return of 1.6%

The US Dollar, as measured by a basket of major currencies, has moved higher in a choppy fashion so far in 2019.

Equity Market Performance
To 29-Mar-2019, in US Dollars

	1st Quarter 2019	12 Months 3/31/19
MSCI World Index	12.5%	4.0%
Europe	10.8%	-3.7%
France	10.7%	-3.7%
Germany	-6.9%	-13.7%
Switzerland	13.1%	7.5%
United Kingdom	11.9%	-0.1%
Japan	6.7%	-7.8%
Pacific, ex Japan	12.2%	4.6%
EAFE	10.0%	-3.7%
USA	13.7%	8.8%
Emerging Markets	9.9%	-7.4%

Source: Morgan Stanley Capital International,
Total return, dividends less withholding tax reinvested.

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Outlook

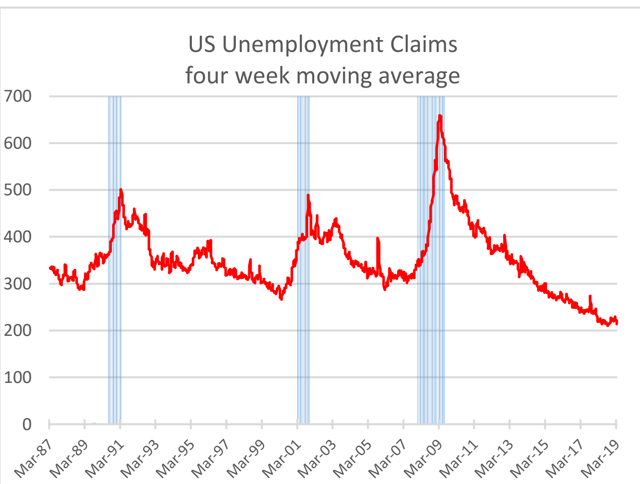
An "inverted curve" has been a reliable indicator of looming recession. However the arrival of recession, on average, takes about a year from the onset of a curve inversion. At this point, there is no need for a panicky response but additional caution is reasonable. On the other hand, when the chorus of commentators sings the "this time is going to be different" song it is time to be wary.

First quarter GDP is expected to be softer than the fourth quarter 2018's rate of growth. But the government shut-down and working-off a trade war induced second-half 2018 inventory build-up, should be relatively short-lived impediments to growth.

Real GDP Growth - YoY %				**Market P/E**
	2018	2019	2020	3-Apr-19
US / S&P 500	2.9	2.4	1.9	18.8
Eurozone / Stoxx 600	1.8	1.2	1.4	17.9
UK / FTSE 100	1.4	1.3	1.5	17.5
China / CSI 300	6.6	6.2	6.0	15.3
Japan / Nikkei 225	0.8	0.7	0.5	16.0
World	3.7	3.4	3.3	

Source: Bloomberg, April 3, 2019

The global economy and global interest rates are heavily influenced by the pace of the U.S. economy. We will take our cues from both the slope of the yield curve and the trend in unemployment claims.



Note: Blue columns represent recession periods Source: Bloomberg, April 4, 2019

Typically, when this weekly claim data series begins to rise towards the 400,000 level, the threat of recession is imminent. While the decline in claims appears to be bottoming out, there is no evidence of a sustained upturn at this point. But, a salient fact to keep in mind is that equity markets anticipate the future, so a sustained rise in unemployment claims will be enough to make us more cautious.

The motive force behind rising share prices is rising earnings. Consensus earnings expectations calls for another year of above average earnings growth, despite slowing global growth. That seems optimistic, but forward earnings are always overly optimistic. The fourth quarter 2019 number looks particularly vulnerable to disappointment / erosion over the course of the year. On the plus side, given the Fed's "pause" in interest rates a modestly higher Price / Earnings ratio over the course of 2019 seems a realistic assumption. We have raised our 2019 year-end price target for the S&P 500 by 100 points to reflect a higher expectation for the market P/E, partially offsetting a haircut to consensus earnings expectations.

Standard & Poor's 500				
	Annual Earnings	%Change Y-o-Y	Price/ Earnings	Year-end Price
Dec-12	86.51	-0.5%	16.5	1426.19
Dec-13	100.20	15.8%	18.5	1848.36
Dec-14	102.31	2.1%	20.1	2058.90
Dec-15	86.53	-15.4%	23.6	2043.94
Dec-16	94.55	9.3%	23.7	2238.83
Dec-17	109.88	16.2%	24.3	2673.61
Dec-18e	132.39	20.5%	18.9	2506.85
Dec-19e	154.92	11.5%	19.4	3000

Source: Standardandpoors.com March 29, 2019

The 3000 price target implies a 20% gain in the S&P 500 for the year 2019. But, keep in mind that the stock market is up nearly 15% already this year. There is no shortage of issues that could create choppy markets on a global scale in the near term, from geopolitics, to trade issues, to Brexit and that is before we get through potential softness in the first quarter earnings season that begins next week. It has always been part of our investment process to maintain individual share price targets and reduce or eliminate those holdings when that price target is achieved. In light of our increased caution, those proceeds will serve to increase cash holdings and allow us to take advantage of any near term pull-back that result from the market's recent extraordinary gains. Further, with a slowing global economy, this stance seems tactically reasonable at this time.

On the fixed-income side, we use bonds in balanced portfolios to mitigate the risk inherent in equity investing and to provide liquidity for unanticipated expenses. We will continue to be very conservative in our bond investments. But if our optimistic scenario plays out longer-term, bond yields will rise and there may be an opportunity to increase income levels through extending our average maturity.

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April 2019
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Data sources: Standardandpoors.com, Bloomberg